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Commonwealth of Massachusetts

Department of Revenue

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# 1999 Massachusetts S Corporation Excise Returns 355S-A/355S-B

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Schedules and Instructions

# General Information

This booklet contains Form 355S-A (for domestic S corporations), Form 355S-B (for foreign S corporations) and most schedules needed to complete your Massachusetts corporation excise return. This booklet also includes an Application for Extension of Time to File, Form 355-7004.

## Major Tax Law Changes for 1999

**Note:** For corporate excise purposes, Massachusetts generally adopts the Internal Revenue Code (IRC) as amended and in effect for the taxable year.

**Three Percent Investment Tax Credit Extended.** The 3% Investment Tax Credit (ITC) has been extended for tax years beginning before January 1, 2004.

### Apportionment Formulas for Certain Manufacturers.

The apportionment formula for corporations engaged in substantial manufacturing (Section 38 corporations) is being adjusted over a five-year period during which the weight of the sales factor is increased 10% a year until it reaches 100% in the year 2000. For taxable year 1999, the following apportionment factor percentages apply: Sales Factor — 90%, Property Factor — 5% and Payroll Factor — 5%.

Corporations other than defense corporations, Section 38 manufacturers or mutual fund service corporations will continue to use the current apportionment formula: Sales Factor — 50%, Property Factor — 25% and Payroll Factor — 25%.

**Brownfields Tax Credit.** Effective for tax years beginning on or after January 1, 1999, taxpayers are allowed a credit for amounts expended to rehabilitate contaminated property owned or leased for business purposes and located within an economically distressed area. In general, the credit is either 25% or 50% of certain environmental response and removal costs incurred between August 1, 1998 and January 1, 2005. The credit that may be taken in any taxable year is limited to 50% of the taxpayer's tax liability. A five year carryforward of unused credit is allowed. The credit may not be used to reduce the excise below the \$456 minimum excise.

**Tangible or Intangible Property Classification.** The process for determining whether a corporation is a tangible property corporation or an intangible property corporation under G.L.c63 ss30.10 and 30.11 has been changed. For purposes of determining whether it is a tangible or intangible property corporation (Schedule B), any corporation (domestic or foreign) may choose to either apply the classification formula applicable to a domestic corporation or the classification formula applicable to a foreign corporation. In addition, regardless of which classification the corporation chooses, any intangible property corporation may choose to determine its taxable net worth (Schedule D) using either the computation formula applicable to a domestic corporation or a foreign corporation. Both Schedule B and Schedule D have been revised to incorporate these changes. See DOR Directive 99-1 and Technical Information Release 99-3.

## How Is S Corporation Income Taxed?

Entities that are S corporations for federal purposes are S corporations for Massachusetts purposes, with the exception of corporate trusts, security corporations and public utility corporations. Items of S corporation income, loss, and deduction are passed through

the S corporation to the shareholders, and reported and taxed on their return. S corporations are liable for the non-income measure of the corporate excise, and for the income measure of the corporate excise on any income that is taxable to the S corporation federally. S corporations owe at least the minimum tax.

### Total Receipts of \$6 Million or more

S corporations with total receipts of \$6 million or more are liable for the income measure of the corporate excise at the following rates:

- 3% on net income subject to tax if total receipts are \$6 million or more, but less than \$9 million; or
- 4.5% on net income subject to tax if total receipts are \$9 million or more.

To determine if an S corporation is liable for the income measure of the corporate excise, complete Massachusetts Schedule S, Part I. If line 12 of Schedule S is at least \$6 million, complete Massachusetts Schedule E and attach a completed pro-forma U.S. 1120. If line 12 of Schedule S is less than \$6 million, Schedule E is not required.

### Aggregation of Total Receipts

If an S corporation and any other entity share common ownership and are engaged in a unitary business, then the total receipts less intercompany transactions of all such entities must be combined according to the rules of 830 CMR 62.17A.1(11)(e) and (f), to determine the dollar amount of such S corporation's total receipts.

"Total receipts" means gross receipts or sales, less returns and allowances, and includes dividends, interest, royalties, capital gain net income, rental income and all other income.

## Who Must File and Pay Corporate Excise?

The purpose of the corporate excise is to require payment for the right granted by the laws of the Commonwealth to exist as a corporation and for the enjoyment under the protection of the Commonwealth's laws of the powers, rights, privileges and immunities derived by reason of the corporate form of existence and operation. The corporate excise is due and payable when any of the following conditions are met:

- the corporation actually does business within the Commonwealth;
- the corporation exercises or continues its charter within the Commonwealth;
- the corporation owns or uses any part of its capital, plant or other property in the Commonwealth; or
- the corporation owns and/or rents real or tangible personal property as a lessor in Massachusetts even without having a usual place of business here.

## Which Form Should an S Corporation File?

Massachusetts S corporations must file either Form 355S-A (domestic S corporations) or Form 355S-B (foreign S corporations) with Schedule S and one Schedule SK-1 for each resident and nonresident shareholder. Schedule S must be completed to report the S corporation's distributive income. The S corporation must also provide a Schedule SK-1 to **each** shareholder to inform the shareholder of the distributive share of items of income, loss, deduction and credit for reporting on the shareholder's Massachusetts return.

A federal S corporation which qualifies as a Massachusetts corporate trust must file **Form 3F**.

All Massachusetts S corporations organized as corporations rather than as corporate trusts continue to be liable for the property measure of the corporate excise or the minimum tax and must complete the relevant sections of Form 355S-A or 355S-B. It must also complete Schedule E of Form 355S-A or 355S-B for any income taxed at the corporate level for federal income tax purposes, or if total receipts are \$6 million or more.

**Note:** Under Massachusetts law, all corporations registered in the Commonwealth are required to file an Annual Report form with the Secretary of State within 2½ months after the close of their fiscal year. The annual report filing fee is \$85. Annual Report forms can be obtained by calling (617) 727-9440. A late fee of \$25 will be assessed to any report which is filed late. For further information on this requirement, refer to MGL Ch. 156B, sec. 109 and Ch. 181, sec. 4 or call the Secretary of State's Corporate Information Line at (617) 727-9640.

## How Does Each Shareholder Report S Corporation Income?

Each shareholder should use the information provided on Schedule SK-1 to complete the shareholder's Massachusetts tax return.

Each shareholder is taxed on the shareholder's share of the S corporation's income whether distributed or not. Each shareholder must report the shareholder's distributive share of S corporation income during the taxable year on the shareholder's Massachusetts tax return.

The following table shows which return should be filed by each type of shareholder.

Type of shareholder	Form to file
Full-year resident individual	1
Part-year resident individual	1-NR/PY
Nonresident individual	1-NR/PY
Trust or estate	2

## What Is Nexus for Massachusetts Corporate Excise Purposes?

A corporation that owns or uses any part of its capital or other property, exercises or continues its charter or is qualified to, or is actually doing business in Massachusetts has nexus with the Commonwealth and must pay a corporate excise. The term "doing business" as defined in MGL Ch. 63, sec. 39 includes:

- the maintenance of a place of business;
- the employment of labor;
- the buying, selling or procuring of services or property;
- the execution of contracts;
- the exercise or enforcement of contract rights; and
- each and every act, power, right, privilege, or immunity exercised or enjoyed in the Commonwealth, as an incident to or by virtue of the powers and privileges acquired by the nature of such organizations, as well as, the buying, selling or procuring of services or property.

Public Law (PL) 86-272 excludes from state net income-based taxation those interstate activities constituting mere solicitation of orders for sales of tangible personal property filled by shipment or delivery from a point outside Massachusetts after orders are sent outside the state for approval or rejection (15 USC sec. 381(a)).

The following are activities that ordinarily fall within the scope of "solicitation" under PL 86-272:

- activities including advertising related to generating retail demand for the products of a manufacturer or distributor by promoting the products to retailers who order the products from a wholesaler or other middleman;
- carrying samples only for display or for distribution without charge or other consideration;
- owning or furnishing automobiles to sales representatives, provided that the vehicles are used exclusively for solicitation purposes;
- passing inquiries and complaints on to home office;
- incidental and minor advertising;
- checking customers' inventories for reorder only;
- maintaining a sample or display area for an aggregate of fourteen calendar days or less during the tax year, provided that no sales or other activities inconsistent with solicitation take place;
- soliciting of sales by an in-state resident representative who maintains no in-state sales office or place of business; and
- training or holding periodic meetings of sales representatives.

For further information on corporate nexus, refer to Regulation 830 CMR 63.39.1.

## Are There Differences Between Massachusetts Tax Law and the Internal Revenue Code Provisions Affecting S Corporations?

Yes. For Massachusetts tax purposes, an S corporation is allowed only those expense deductions that an individually owned business is allowed. Deductions that are itemized by an individual on Schedule A of U.S. Form 1040 are not allowed. The deductions for charitable contributions or for a net operating loss carryover or carryback are neither allowed to S corporations nor to an individual under Massachusetts income tax law. However, S corporations with total receipts of \$6 million or more are allowed a Massachusetts net operating loss for purposes of calculating their additional excise liability.

Schedules S and SK-1 isolate income and deduction items in order to produce the correct Massachusetts S corporation total as well as each shareholder's correct Massachusetts distributive share. These amounts often differ from those reported on U.S. Form 1120S and Schedule K-1.

## S Corporation Additional Excise: What Are the Differences Between Massachusetts Income and Federal Income?

Gross income for corporate excise purposes is the same as that defined under the U.S. IRC, as amended and in effect for the taxable year, with the following additions:

- interest from the bonds, notes and evidences of indebtedness of any state, including Massachusetts.
- Net income is gross income less the deductions, but not the credits, allowable under the U.S. IRC. The following deductions are not allowed:
- dividends received (See Schedule E-1 instructions)

- taxes on or measured by income, franchise taxes measured by income, franchise taxes for the privilege of doing business and capital stock taxes imposed by any state or U.S. territory.

The deduction for losses sustained in other taxable years is allowed subject to certain restrictions. See Schedule E-2 for further information.

S corporations with total receipts of \$6 million or more are liable for the income measure of the corporate excise at the following rates:

- 3% on net income subject to tax if total receipts are \$6 million or more, but less than \$9 million; or
- 4.5% on net income subject to tax if total receipts are \$9 million or more.

To determine if an S corporation is liable for the income measure of the corporate excise, complete Massachusetts Schedule S, Part I. If line 12 of Schedule S is at least \$6 million, complete Massachusetts Schedule E and attach a completed pro-forma U.S. 1120. If line 12 of Schedule S is less than \$6 million, Schedule E is not required.

## Are There Special Tax Credits Available in Massachusetts?

Yes. Massachusetts offers several special credits and deductions to corporations. Under MGL Ch. 63, sec. 32C, a corporation's credits may not offset more than 50% of its excise. Any credits not utilized as a result of this provision may be carried over for an unlimited number of years. This provision does not apply to the Research Credit, Harbor Maintenance Tax Credit, Full Employment Credit, or Brownfields Credit.

### Investment Tax Credit

Manufacturing corporations and corporations engaged primarily in research and development, agriculture or commercial fishing are allowed a credit of 3% of the cost of depreciable real and tangible property. Such property must have a useful life of four years or more or a recovery period of three years or more. The property must be used and located in Massachusetts on the last day of the taxable year. A corporation cannot take the credit on property which it leases to another. A corporation can take the credit on property it leases from another (for property leased and placed in service on or after July 1, 1994). Generally, eligible corporate lessees making qualifying leasehold improvements may claim the credit. The credit may be claimed by completing Schedule H. Also, if claiming this credit, Schedule F-2 must be completed for informational purposes.

**Note:** Motor vehicles and trailers acquired on or after January 1, 1988 and subject to the motor vehicle excise do not qualify for the Investment Tax Credit.

A corporation may carry over to the **next succeeding three years** any unused portion of its Investment Tax Credit. This carryover may be taken by completing Schedule H.

### Poverty Area Credit and Deduction

A corporation operating an eligible business facility in an eligible area of substantial poverty is allowed a credit to minimize property tax differentials among communities. The credit is the amount by which the eligible community's equalized property tax rate exceeds the average state equalized property tax rate per \$1,000 of assessed valuation.

The corporation is allowed to deduct an additional 25% of the compensation paid to certain employees working in an eligible business facility. In order to qualify for this credit, the facility must be located in or contiguous to federally certified areas of concentrated unem-

ployment or underemployment, or areas containing poor or disadvantaged tracts. All eligible areas and facilities are defined and certified by the Urban Job Incentive Bureau, Executive Office of Economic Affairs, One Ashburton Place, Room 2101, Boston, MA 02108. No deduction can exceed \$5,000 for any eligible employee.

To qualify for the credit and deduction, the facility must have been operational prior to June 30, 1985 and have met one of the following conditions prior to January 1, 1983:

- on-site construction must have started; or
- binding construction contracts must have been entered into; or
- land or leasehold interests must have been acquired.

The facility must also have approved training or assistance programs and hire at least 20% of its employees from eligible areas.

To claim the credit and additional deduction, Schedules I and I-1 must be completed. The credit is reconciled with your other credits on Schedule H and then taken in line 8 of the Computation of Excise. The additional deduction is taken in line 18 of Schedule E.

### Vanpool Credit

Foreign and domestic corporations are allowed a credit of 30% of the cost incurred during the taxable year for the purchase or lease of company shuttle vans used in the Commonwealth as part of an employer-sponsored ridesharing program. The shuttle vans must be used for transporting employees and students from their homes, or public transportation facilities, to their places of employment or study.

To claim the Vanpool Credit, Schedule VP must be completed. This credit is reconciled with your other credits on Schedule H and claimed in line 10 of the Computation of Excise.

### Solar or Wind Power Deduction

A deduction is allowed for expenditures paid or incurred during the year for solar or wind power climate control or water heating units. Expenditures for ancillary units are not allowed. The equipment must be certified by the Office of Facilities Management, Division of Capital Planning, (617) 727-4030. This deduction should be taken in line 17 of Schedule E.

### Economic Opportunity Area Credit

A credit of 5% of the cost of qualifying property purchased for business use within an Economic Opportunity Area (EOA) is now available to businesses. To qualify for the EOA credit, the property must be eligible for the 3% ITC and be used exclusively in a certified project in an EOA. However, a 3% ITC and 5% EOA credit cannot be claimed with respect to the same property. A certified project is a project that has been approved by the Economic Assistance Coordinating Council (EACC).

The 5% EOA credit cannot offset more than 50% of the excise due nor reduce the excise below the minimum excise. Personal income taxpayers are subject to a similar 50% limitation. Any unused credit may be carried forward for ten years.

To claim the credit, Schedule EOA must be completed. This credit is reconciled with your other credits on Schedule H and claimed in line 7 of the Computation of Excise.

### Research Credit

A deduction is allowed for corporations which have incurred basic research payments and/or qualified research expenses for research conducted in Massachusetts during the taxable year. A corporation taking the research credit is allowed to deduct from excise:

- 100% of the first \$25,000 of excise; and
- 75% of any amount of excise remaining after the first \$25,000.

The credit is available for expenditures incurred on or after January 1, 1991.

The deduction allowed to an S corporation for any expenses which qualify for the credit must be reduced by the amount of the credit claimed for the taxable year.

S corporations which are under common control with any trade or business (such as a trust) are treated as a single taxpayer for purposes of determining the allowable Research Credit.

See Schedule RC or Schedule RC-A instructions for further information. To claim the Research Credit, Schedule RC or Schedule RC-A must be completed and the amount entered in line 12 of the Computation of Excise.

### Harbor Maintenance Tax Credit

Corporations are allowed a credit against the corporate excise for certain harbor maintenance taxes paid to the U.S. Customs Service pursuant to IRC Section 4461. A corporation is eligible for the credit if the tax paid is attributable to the shipment of break-bulk or containerized cargo by sea- and ocean-going vessels through a Massachusetts harbor facility.

The credit is not subject to the 50% limitation, however it may not reduce the tax to less than the minimum excise of \$456. A taxpayer may carryover any excess credit to any of the next succeeding five taxable years.

See Schedule HM instructions for further information. To claim the Harbor Maintenance Tax Credit, Schedule HM must be completed and the amount entered in line 15 of the Computation of Excise.

### Full Employment Credit

Corporations who participate in the Full Employment Program and continue to employ a participant for at least one full month after any Full employment Program subsidy has expired may claim the Full Employment Credit. A qualified employer may claim a credit equal to \$100 per month of eligible employment per participant with a maximum credit of \$1,200 per participant. Qualified participants and employers are those who participate in the Full Employment Program under the rules of the Department of Transitional Assistance.

The credit is not subject to the 50% limitation, however it may not reduce the tax to less than the minimum excise of \$456. A taxpayer may carryover any excess credit to any of the next succeeding five taxable years.

See Schedule FEC instructions for further information.

### Brownfields Tax Credit

See page 2 of the instructions, Major Tax Law changes for 1999, for general information on this credit.

See Schedule BC instructions for further information. To claim the Brownfields Credit, Schedule BC must be completed and the amount of the credit entered in line 13 of the Computation of Excise.

### What if a Corporation's Taxable Year Is Less Than 12 Months?

S corporations whose taxable year is less than twelve calendar months may determine their excise by prorating calendar months for the **non-income** measure of the excise only. Schedules should be attached to explain any prorating computations.

A corporation may never pay less than the \$456 minimum excise on a return, and this amount can never be prorated as Massachusetts law makes no provision for the proration of the minimum excise.

### When Are Returns Due?

S corporation excise returns, together with payment in full of any tax due, must be filed on or before the 15th day of the third month after the close of the taxable year, calendar or fiscal.

An extension of time for filing returns will be granted for reasonable cause upon request. In order to request an extension, a corporation must file Form 355-7004 on or before the normal due date of the return and pay in full the estimated tax due. An extension of time to file is not valid if the corporation fails to pay at least 50% of the total tax liability through estimated payments or with Form 355-7004.

Any tax not paid on or before the due date — without regard to the extension — shall be subject to interest charges.

### What Is a Proper Return?

A proper return is a return upon which all required amounts have been entered in all appropriate lines on all forms. Data sheets, account forms or other schedules may be attached to explain amounts entered on the forms. However, referencing lines to attachments in lieu of properly entering all amounts onto the return is not sufficient. An exact copy of all pages of U.S. Form 1120S as filed must be attached to this return with applicable schedules and forms required to substantiate the Massachusetts excise. Also, if total receipts are \$6 million or more the corporation must complete and attach a pro forma U.S. Form 1120 and Massachusetts Schedule E.

### Should the S Corporation Be Making Estimated Tax Payments?

All S corporations which reasonably estimate their corporate excise to be in excess of \$1,000 for the taxable year are required to make estimated tax payments to the Commonwealth. Estimated taxes may be paid in full on or before the 15th day of the third month of the S corporation's taxable year or in four installment payments according to the schedule below. Corporations making estimated payments must use Form 355-ES to make their payments.

Corporate estimated tax installments are paid as follows:

<u>Installment no.</u>	<u>% of estimated tax due</u>	<u>Due date from start of taxable year</u>
1	40%	15th day of 3rd month
2	25%	15th day of 6th month
3	25%	15th day of 9th month
4	10%	15th day of 12th month

**Note:** New corporations in their first full taxable year with less than 10 employees have different estimated payment percentages — 30%, 25%, 25% and 20% respectively.

Special Optical Character Readable payment vouchers are mailed to all corporations which have made estimated payments or should be making estimated payments.

Participation in Electronic Funds Transfer (EFT) of estimated tax payments is required for all business and manufacturing corporation excise tax filers whose annual corporate excise tax liability exceeds \$250,000. For further information, please call the Department's Automated Processing Bureau at (617) 887-5020.

For more information on corporate estimated taxes, refer to 830 CMR 63B.2.2 and MGL Ch. 63B.

# Schedule Instructions

These schedule instructions apply to both Form 355S-A (domestic S corporations) and Form 355S-B (foreign S corporations) except where noted.

## Registration Information

Enter the corporation's federal business code and federal identification number to the right of the corporation name box.

### Line 2

Briefly describe the nature of the corporation's business, e.g., manufacture, retail, etc.

### Line 6

If you check Classified Manufacturing as applying to your corporation, you must have filed Form 355Q and had your manufacturing status approved by the Commissioner.

#### (355S-A only)

A domestic business qualifies as an R & D corporation only if: its principal activity is research and development; more than  $\frac{2}{3}$  of its total receipts for the taxable year are derived from research and development; and more than  $\frac{1}{3}$  of its receipts for the taxable year are derived from the research and development of tangible personal property capable of being manufactured in the Commonwealth.

#### (355S-B only)

A foreign business qualifies as an R & D corporation only if: its principal activity is research and development; more than  $\frac{2}{3}$  of its total receipts assignable to Massachusetts (for the taxable year) are derived from research and development; and more than  $\frac{1}{3}$  of its receipts assignable to Massachusetts (for the taxable year) are derived from the research and development of tangible personal property capable of being manufactured in Massachusetts.

### Line 7

If your corporation has undergone a federal audit for some prior year, you must report any changes to Massachusetts on Form 355FC. You must report any federal audit changes within three months after the final determination of the correct taxable income by the IRS. Otherwise, you will be subject to a penalty. Answering yes to line 7 does not relieve the corporation from this filing obligation.

### Line 9

If the corporation is requesting alternative apportionment under MGL Ch. 63, sec. 42, check the box in line 9 and attach Form AA-1. Both this return and Schedule F must be completed and the tax must be paid according to the statutory three-factor formula. However, alternative treatment may be requested and a refund will be issued if such treatment is granted by the Commissioner of Revenue. If you are requesting alternative apportionment, mail your complete corporation excise return, with all schedules and attachments to Massachusetts Department of Revenue, PO Box 7044, Boston, MA 02204. For further information on alternative apportionment see MGL Chapter 63, sec. 42 or 830 CMR 63.42.1.

### Line 10

A defense corporation may elect to apportion its net income using a formula based solely on its sales factor. A corporation is a defense corporation if it was in existence during the entire sixty month period

ending on December 31, 1995, and it derived more than fifty percent of its receipts during such period from the manufacture of tangible personal property for sale directly, or in the case of a subcontractor, indirectly to the United States Department of Defense or any branch of the United States armed forces.

For taxable year 1999, the following apportionment factors apply for corporations engaged in substantial manufacturing (Section 38 manufacturers): Sales Factor — 90%; Property Factor — 5%; and Payroll Factor — 5%.

A corporation is a Section 38 manufacturer for any taxable year if it is engaged in manufacturing during the taxable year and its manufacturing activity during the taxable year is substantial, regardless of whether the corporation is a domestic manufacturing corporation under MGL Ch. 63, sec. 38C or a foreign manufacturing corporation under MGL Ch. 63, sec. 42B, and regardless of whether the corporation is classified as a manufacturing corporation under MGL Ch. 58, sec. 2 and Massachusetts Regulation 830 CMR 63.58.2.1.

A corporation's manufacturing activity is substantial for any taxable year if the corporation meets any of the following tests:

- The corporation derives twenty-five percent or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures; or
- The corporation pays twenty-five percent or more of its payroll for the taxable year to employees working in manufacturing operations and derives fifteen percent or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures; or
- The corporation uses twenty-five percent or more of its tangible property in manufacturing during the taxable year and derives fifteen percent or more of its receipts for the taxable year from the sale of manufactured goods that the corporation manufactures; or
- The corporation uses thirty-five percent or more of its tangible property in manufacturing during the taxable year.

Effective January 1, 1997, mutual fund service corporations are required to attribute their mutual fund sales to Massachusetts based on the domicile of the shareholders in the fund. Effective July 1, 1997 mutual fund service corporations are allowed to apportion their net income from mutual fund sales based solely on their sales factor. However, in order to use the single sales factor apportionment method a mutual fund service corporation must increase its workforce in Massachusetts by 5% a year for five years based on the 1996 employment level unless adverse economic conditions exist. Taxable net income not derived from mutual fund sales is apportioned according to the statutory three factor method.

A corporation is a mutual fund service corporation if it derives more than fifty percent of its gross income from providing, directly or indirectly, management, distribution or administration services to or on behalf of a regulated investment company, and from trustees, sponsors and participants of employee benefit plans which have accounts in a regulated investment company.

The Department plans to issue further guidance on apportionment for mutual fund service corporations; see proposed Massachusetts Regulation 830 CMR 63.38.7.

If a corporation qualifies as a defense corporation and elects to apportion its net income based solely on the sales factor or is qualified as a Section 38 manufacturer or is a mutual fund service corporation, check the applicable box and complete Schedule F, Income Apportionment, accordingly. Defense corporations electing single sales factor apportionment, Section 38 manufacturers and mutual fund service corporations must also complete and attach Form F-2. Form F-2 is available at any Department of Revenue location.

The Department plans to issue further guidance on apportionment; see Massachusetts Regulation 830 CMR 63.38.1.

#### Line 11

A corporation undergoing a voluntary dissolution must contact: Massachusetts Department of Revenue, Customer Service, Certificates Unit, PO Box 7021, Boston MA 02204, or call (617) 887-6550.

### Computation of Excise

In order to complete the Computation of Excise, all appropriate schedules must be filled out first. Therefore, schedule instructions precede the instructions for the Computation of Excise section.

### Schedule A. Balance Sheet

The Schedule A balance sheet includes columns for the original cost, accumulated depreciation or amortization and net book value of the corporation's assets. Enter the closing amounts for the taxable year covered by this return. Once the corporation's balance sheet is completed, it will be easier to complete subsequent schedules.

#### Line 1a

Enter here the book value of all buildings. A portion of the cost attributable to buildings under construction and reported on the corporation's books as construction in progress (CIP) is considered real estate for purposes of the property measure of the corporate excise and must be reported in line 1a. Enter 100% of the corporation's real estate CIP costs, less 15% of the **current year's** accumulation. This 15% is considered tangible property and must be reported in line 1k.

#### Line 1j

The value of any certified solar/wind units for which a deduction is claimed this year should be entered here. Amounts of certified industrial waste and/or air pollution treatment facilities and certified solar/wind deductions claimed in any prior year should be included. (In order to be eligible for this deduction, property must be certified by the appropriate state agencies and copies of such certificates must be attached to this return. See instructions for Schedule E, line 17.)

#### Line 1k

Enter here the value of all tangible property reported on the corporation's books as CIP. In addition, enter here 15% of the **current year's** real estate CIP accumulation.

#### Line 2b

Enter here the value of inventory that is exempt from the tangible property measure of the excise. An example of exempt inventory is merchandise of foreign origin imported and immediately placed in a federally bonded warehouse. Merchandise of domestic origin is not exempt from the tangible property measure of the excise. A schedule listing the components of any entry in line 2b must be attached.

#### Line 12 (355S-A only)

Enter investments in capital stock only. (Investments which account for more than 80% of the voting stock of a corporation organized in Massachusetts should be entered in line 12a.)

#### Line 12 (355S-B only)

Enter the value of capital stock investments in foreign subsidiary corporations not doing business in Massachusetts. In order to be a subsidiary, the parent must own 80% or more of voting stock of a corporation in accordance with IRC Sec. 1504. Advances to such corporations that are includible are payments in the nature of capital contributions and not loans or other receivables. Attach a schedule listing the name, percentage of ownership, and amounts of investments and advances to each foreign subsidiary not doing business in Massachusetts.

#### Line 14

If the reserve for bad debt exceeds 2% of accounts receivable, attach a complete explanation to enable a review and determination of the proper amount allowable.

#### Line 17

Enter here the value of any assets not included in lines 1 through 16. Examples include, but are not limited to, goodwill and company patents.

#### Line 19a

Enter the value of mortgages on Massachusetts real estate, motor vehicles, machinery owned by a corporation which is not classified as a manufacturing corporation, and other tangible personal property located in Massachusetts and subject to local taxation. Mortgages do not include conditional sales, pledges or other types of security interest.

All items in Schedule A should be accompanied by a separate schedule if an explanation is required.

### Schedule A-1. Leased Property

Schedule A-1, Leased Property, has been deleted from the returns. If the Department subsequently requires this information it will request it at that time.

### Schedules B, C and D. Tangible or Intangible Classification and Calculation of Non-Income Measure

Schedules B, C and D are used to calculate the non-income measure of the Massachusetts corporate excise. Schedule B is used to determine whether a corporation is a tangible or intangible property corporation. Once determined, tangible property corporations must complete Schedule C (and omit Schedule D) and intangible property corporations must complete Schedule D (and omit Schedule C). Net book values should be used in completing all schedules.

#### Schedule B

Schedule B is used to calculate whether a corporation is a tangible or intangible property corporation. The calculations done on lines 1 through 13 determine the property percentage as if the corporation is a domestic corporation. Completing the schedule through line 18 determines the property percentage as if it were a foreign corporation. The corporation is then allowed to choose the percentage from either line 13 or line 18. One of these two is entered on line 19. If line 19 is 10% or greater, complete Schedule C. If line 19 is less than 10%, complete Schedule D. The corporation may annually elect to calculate its non-income measure as a domestic or foreign taxpayer.

For line 14, domestic corporations must determine the portion of the amount reported in line 12c of Schedule A of Form 355A that is attributable to investments in foreign corporations not doing business in Massachusetts. Line 14 should not include any advances to such corporations. Line 14 for foreign corporations is equal to the total of Form 355B, Schedule A, line 12a, less advances included in line 12a, plus line 12b.

### Schedule C

If a corporation's ratio, the — "tangible property percent" — is 10% or greater, the corporation must complete Schedule C using net book values to determine the non-income measure of the excise. Omit Schedule D.

### Schedule D

Schedule D is used by a corporation to calculate its non-income measure excise on the basis of net worth. If line 19 of Schedule B is less than 10%, complete this schedule. Corporations are allowed to deduct the value of investments in, and advances to, Massachusetts and foreign subsidiaries. To be a subsidiary, the parent must own 80% or more of the voting stock of the corporation in accordance with IRC Section 1504.

Beginning January 1, 1999, a corporation can calculate its net worth either as a domestic or foreign corporation.

The corporation is allowed to annually change this election. The calculation as a domestic corporation is done on lines 1 through 9. To calculate net worth as a foreign corporation, continue through line 22. Enter the smaller of lines 9 or 22 on line 23.

## Schedule E-1. Dividends Deduction

Massachusetts corporate excise law does not allow the dividends received deduction allowed under the IRC. However, a deduction is allowed for 95% of the value of all dividends received except:

- dividends from ownership of shares in a corporate trust engaged in business in the Commonwealth;
- dividends resulting from deemed or actual distributions (except actual distributions of previously taxed income) from a DISC which is not wholly-owned; or
- dividends from any class of stock if the corporation owns less than 15% of the voting stock of the payer corporation.

A schedule showing payers, amounts and percent of voting stock owned by class of stock must accompany Schedule E-1.

## Schedule E-2. Loss Carryover Deduction

### S Corporation Net Operating Loss Carryover

Under Chapter 202 of the Acts of 1988, S corporations with total receipts of \$6 million or more are allowed to carry over for no more than five years (but not carry back) net operating losses (NOL) as defined in IRC Sec. 172, from tax years 1989 and thereafter.

Beginning with losses from tax years 1989 and thereafter, S corporations with receipts of \$6 million or more are also allowed a carry-over deduction for losses incurred during the first five years of an S corporation's existence.

A corporation may only take one of these deductions. Either NOL is allowed only for purposes of calculating the additional excise imposed on S corporations with total receipts of \$6 million or more.

Instructions for Schedule E-2 can be found on Schedule E-2 in this booklet.

## Schedule E. Taxable Income

Mutual fund service corporations eligible to apportion their income under MGL Ch. 63, sec. 38 (m) must complete two separate Schedule Es: (1) for income derived from mutual fund sales; and (2) for non-mutual fund sales income, if any. Taxable net income from mutual fund sales is gross income from mutual fund sales less: (1) any deductions directly traceable to its mutual fund sales; and (2) a portion of other allowable deductions. Other allowable deductions consist of deductions not directly traceable to mutual fund sales or non-mutual fund sales. To determine the deductible amount of its other allowable deductions a mutual fund service corporation must multiply the total amount of its other allowable deductions by a fraction, the numerator of which is the mutual fund service corporation's gross income derived from mutual fund sales for the taxable year and the denominator of which is the mutual fund service corporation's total gross income for the taxable year. Taxable net income from non-mutual fund sales consists of any taxable net income not derived from mutual fund sales.

If a corporation is not a mutual fund service corporation in lines 1 through 9, 100% of sales, profits, and income should be entered. If the corporation has income from business activities which is taxable both in Massachusetts and any other state, Schedule F should be completed and the apportionment percentage entered in line 15.

### Line 4

Enter federal taxable income before deducting net operating loss or other special deductions.

### Line 5

Subtract from Schedule E, line 4 any allowable U.S. Wage Credit used in calculating U.S. Form 1120, line 13. Enter the result in line 5.

### Line 6

Enter all interest received on state and municipal obligations not reported in federal net income.

### Line 7

Massachusetts does not allow a deduction for state, local and foreign income, franchise, excise or capital stock taxes. Any such taxes which have been deducted from federal net income should be entered in line 7 and added back into income.

### Line 8

Enter any adjustments to income not previously reported and attach a schedule explaining them. For example, enter in this line the amount of depreciation or amortization taken this year in computing federal net income for the following:

- certified industrial waste and/or pollution treatment facilities of prior years; or
- certified solar/wind units of current or prior years, if said facilities were sold during the year. (See MGL Ch. 63, sec. 38D(d) and sec. 38H(e) for further explanation.)

Capital gains on installment sales of intangible property made prior to 1963 may also be deducted from income. These gains fall under the provisions of prior Massachusetts law when such income was not taxable (see MGL Ch. 63, sec. 38(a)(2)). This adjustment should be made in line 8.

Deduct the full federal research credit generated provided that the full federal research credit was taken. If a reduced federal research credit was taken, no adjustments are necessary.



In the "Total tentative research credit" line of Schedule RC, add back the full Massachusetts research credit generated.

The deduction allowed to an S corporation for any expense which qualifies for the Massachusetts Research Credit must be reduced by the Massachusetts Research Credit determined in the current taxable year. In addition, subsection (c) of Section 280C of the IRC, which requires a similar reduction of the deduction, shall not apply in determining Massachusetts net income.

#### Line 10

Enter the total cost of renovating an abandoned building in an Economic Opportunity Area. Multiply this amount by 10% and enter the result in line 10.

#### Line 11

Refer to Schedule E-1 for the allowable deductions for dividends. Dividends from a Massachusetts corporate trust, a non-wholly-owned DISC or a corporation of which less than 15% of the voting stock is owned are not deductible.

#### Line 13

There are two possible Massachusetts loss carryover deductions for S corporations with total receipts of \$6 million or more. Complete Schedule E-2 to calculate the allowable amount of loss which may be carried forward and entered in this line. A complete schedule of federal loss carryback and carryforward computations should be attached.

#### Line 15

If the corporation conducts business activities in another state sufficient to give that state the jurisdiction to tax the corporation, Schedule F should be completed in order to determine the apportionment percentage. If all business is conducted in Massachusetts, 100% should be entered in line 15.

#### Line 17

A deduction is allowed for expenditures paid or incurred during the taxable year for the installation of any solar or wind powered climate control or water heating unit. Ancillary units do not qualify.

In order to be eligible for this deduction, the property must be certified by the Office of Facilities Management. A copy of such certification must be submitted along with a schedule itemizing the:

- cost;
- allowable federal depreciation;
- date of installation; and
- place of installation.

If these amounts are prorated, the computation should be explained.

If eligible units do not continue in qualified use for ten years, the deductions previously allowed must be added back to taxable income. The computation of any such additional income should be explained in an attached schedule and the amount should be entered in Schedule E, line 8.

**Note:** The special deduction for the construction of certified industrial waste and/or air pollution treatment facilities does not apply to expenditures paid or incurred on or after January 1, 1980.

## Corporate Disclosure Schedule

Chapter 402 of the Acts of 1992 requires the Department of Revenue to conduct an annual analysis of corporate tax liability. To pro-

vide the Department with information necessary to complete this analysis, corporations are required to report amounts taken federally for charitable contributions, research expenses and certain types of depreciation. All corporations must complete the Corporate Disclosure Schedule on their return or the return will be considered insufficient and will be subject to applicable penalties and interest.

## Schedule F. Income Apportionment

Instructions for Schedule F can be found on Schedule F in this booklet.

## Schedule H. Investment Tax Credit and Carryovers

The Investment Tax Credit equals 3% of the cost or other federal basis of qualifying property less any U.S. Investment Tax Credit taken on such property (including any amount of federal credit on the property which is carried to another year, TIR 87-2). To qualify for the credit, the property must be tangible personal property, buildings or structural components of buildings; it must have been acquired, constructed, reconstructed, or erected during the taxable year. The property must also (a) be depreciable, (b) have been acquired by purchase pursuant to Section 179(d) of the U.S. Internal Revenue Code, (c) have a useful life of 4 years or more or a recovery period of 3 years or more, (d) be used in Massachusetts, and (e) be situated in Massachusetts on the last day of the taxable year. A corporation cannot take the credit on property it leases to another. A corporation can take the credit on property it leases from another (for property leased and placed in service on or after July 1, 1994). Generally, eligible corporate lessees making qualifying leasehold improvements may claim the credit.

### Part 1

To be eligible for the credit, a corporation must be (a) engaged in manufacturing during the taxable year, or primarily engaged in (b) agriculture, (c) commercial fishing, or (d) research and development. A corporation qualifies under (d) only if its principal activity is research and development and more than  $\frac{1}{2}$  of its total receipts for the taxable year (or  $\frac{2}{3}$  of receipts assignable to Massachusetts if a foreign corp.) are derived from research and development, and more than  $\frac{1}{3}$  of its receipts for the taxable year (or  $\frac{1}{2}$  of receipts assignable to Massachusetts if a foreign corp.) are derived from the research and development of tangible personal property capable of being manufactured in Massachusetts.

### Part 2

Useful life of property is the same for Massachusetts purposes as for federal tax purposes.

For leased property the credit is based on the lessor's adjusted basis in the leased property (determined at the beginning of the lease term) multiplied by a fraction, the numerator of which is the number of days of the taxable year during which the lessor leases the property and the denominator of which is the number of days in the useful life of the property. Useful life is the period over which the lessor depreciates the leased property for federal tax purposes.

If property qualifying for the Investment Tax Credit is disposed of or ceases to be in qualified use during the year of purchase, the credit allowed is 3% of the federal basis of the property (less any U.S. Investment Tax Credit taken) multiplied by this formula:

$$\frac{\text{Months of qualified use}}{\text{Total months of useful life}}$$

**Note:** Corporations are required to submit a separate statement explaining the job opportunities created by the Investment Tax Credit. The statement must include both the number of new jobs created and/or existing jobs protected by the new investment. Include on the statement any other information considered to be pertinent to employment in Massachusetts.

#### Parts 3 and 4

Use these sections to calculate (a) the number of credits available in the current year, (b) the total number of credits which may be used in the current year to offset the excise — including the order in which the various types of credits are to be used, and (c) the number and status (limited or unlimited life) of credits that may be carried to subsequent years.

#### Column B. Order in Which Credits Are To Be Used

Credits should be used in the order of lines 13 through 26. This order will prevent the unnecessary lapsing of credits by giving priority to credits which lapse first.

#### Line 26, Column A. Unlimited Credit Carryover from Prior Years

These are credits earned in past years whose use was disallowed by the rule that only 50% of the excise may be offset by credits.

### Schedule H-2. Credit Recapture

#### Recapture

If property is disposed of or ceases to be in qualified use prior to the end of its useful life, the difference between the credit taken and the credit allowed for actual use must be added back in Form 355S-A or 355S-B, line 21 of Computation of Excise, as additional taxes in the year the property is disposed of. The amount of credit allowed for actual use is determined by this formula:

$$\text{Original Credit} \times \frac{\text{Months of qualified use}}{\text{Total months of useful life}}$$

If the property has been in qualified use for more than 12 consecutive years, it is not necessary to add back the credit.

#### Line 9

If the taxpayer's records show that a portion or all of the original credit was never used to offset tax, the recapture tax may be reduced by the unused amount. To substantiate an amount in line 9 of Schedule H-2, taxpayers are required to complete and attach the Schedule H-2 Worksheet (Recapture Offset Worksheet) or to attach their own schedule, provided it performs the same calculations as the worksheet. The worksheet is included in the Massachusetts Package X or may be obtained by calling the Customer Service Bureau at (617) 887-MDOR or by visiting one of the DOR locations listed on the inside back cover.

For further information on Investment Tax Credit Recapture, refer to DOR Directive 89-7.

### Schedule S. S Corporation Distributive Income

**Note:** In the following Schedule S and SK-1 instructions only certain items are addressed in detail. Lines without specific instructions are considered to be self-explanatory.

### Part I Classification Information

#### Line 1

Enter the total amount of gross receipts or sales from U.S. Form 1120S, line 1c. Returns and allowances are subtracted in reaching this amount.

#### Line 11

Enter the total amount of other income not included in lines 1 through 10. Include income from U.S. Form 1120S, line 5, and U.S. Form 1120S, Schedule K, lines 4f and 6. If an S corporation is a partner in a partnership, include the amount of its distributive share of the partnership's total receipts not included in lines 1 through 10. Include all tax-exempt income. Also enter any other items included in an entity's gross income under IRC Sec. 61 and not included in lines 1 through 10.

#### Line 12b

Enter only those receipts from intercompany transactions that are included in lines 1 through 11. Do not include receipts from related entities included in 12d below.

#### Line 12d

Enter here the aggregated total receipts less receipts from intercompany transactions for all entities other than the S corporation that share common ownership and are engaged in a unitary business with the S corporation according to 830 CMR 62.17A.1 (11)(e) and (f). Attach a supporting schedule for each entity clearly stating all items of total receipts and intercompany transactions.

### Part III S Corporation Income

#### Mass. Ordinary Income or (Loss)

#### Line 13

Enter the amount of ordinary income or (loss) from U.S. 1120S, line 21. Do not include interest, dividends, and other portfolio income included in line 21. Enter such income on lines 23 through 29.

#### Line 14

If reporting other income or (loss) from U.S. Form 1120S, Schedule K, line 6, attach a statement and explain.

#### Line 15

Enter total foreign, state or local income, franchise, excise or capital stock taxes deducted from U.S. income. These taxes are deductible for U.S. tax purposes, but are not deductible in Massachusetts.

#### Line 17

Enter in line 17 any income or (loss) included in lines 13 and/or 14 that is granted capital gains treatment by the federal government or is classified as a capital gain or (loss) for Massachusetts purposes.

For Massachusetts purposes capital gain or (loss) is the gain or (loss) from the sale or exchange of a capital asset. A capital asset is: (1) an asset which is capital asset for federal income tax purposes or (2) property that is used in a trade or business within the meaning of IRC section 1231(b) without regard to the holding period defined in said section 1231(b).

#### Line 19

Report and describe any other adjustments to Massachusetts income and deductions not reported elsewhere on Schedule S.

For Massachusetts tax purposes, an S corporation is allowed only those expense deductions that an individually owned business is allowed. Deductions that are itemized by an individual on Schedule A

of U.S. Form 1040 are not allowed. The deductions for charitable contributions or for a net operating loss carryover or carryback are neither allowed to the S corporation nor to an individual under Massachusetts income tax law.

If an S corporation is taxable at the federal level, and thus at the state level, on passive investment income under IRC Sec. 1375, then such income passed through to the shareholder is reduced by the item's portion of the tax paid at the federal and state level. Reduce the S corporation's Massachusetts ordinary income by the amount of the federal and state tax paid by the S corporation. Attach the computation of the tax shown on U.S. Form 1120S, line 22(b).

Also report the cost of renovating a qualifying abandoned building. Attach a statement detailing the location and cost of renovating the qualifying abandoned building.

#### Line 21

Enter the net income or (loss) from rental real estate activity(ies) from U.S. Form 1120S, Schedule K, line 2.

#### Line 22

Enter the net income or (loss) from other rental activity(ies) from U.S. Form 1120S, Schedule K, line 3c.

#### U.S. Portfolio Income

#### Line 23

Add U.S. Form 1120S, Schedule K, lines 4a, 4b, 4c and 4f and enter the total in line 23.

#### Line 24

Enter the total amount of interest on U.S. debt obligations reported in line 23 which is taxable by the federal government, but is tax-exempt in Massachusetts.

#### Line 25

Enter the total amount of interest from Massachusetts banks included in line 23. Report any interest from Massachusetts savings accounts, saving share accounts and NOW accounts. Also report any interest from term and time deposits. Attach a statement listing bank sources and amounts.

**Note:** This amount should not include any 5.95% interest from Massachusetts banks derived in the ordinary course of the trade or business activity of the S corporation, and properly reported in line 13.

#### Line 26

Enter the total amount of interest (other than from Massachusetts banks) and dividend income included in line 23. Do not include interest on U.S. debt obligations which is taxable by the federal government, but is tax-exempt in Massachusetts. Attach a statement listing sources and amounts.

#### Line 27

Enter the total amount of the S corporation's non-Massachusetts state and municipal bond interest. This interest is taxable in Massachusetts but not taxed by the federal government and thus not reported on U.S. Form 1120S, Schedule K, line 4a.

#### Line 28

Enter the total amount of royalty income included in line 23.

**Note:** This amount should not include any royalty income derived in the ordinary course of the trade or business activity of the S corporation and properly reported in line 13.

#### Line 29

Enter the total amount of other income included in line 23 (from U.S. Form 1120S, Schedule K, line 4f).

#### Capital Gains and Losses

If the S corporation had any income or (loss) reported in U.S. Form 1120S, Schedule K, line 6 that is granted capital gains treatment by the federal government, include that amount in lines 30–37, as applicable.

#### Line 30

Enter the total short-term capital gains included in U.S. Form 1120S, Schedule D, line 4.

#### Line 31

Enter the total short-term capital (losses) included in U.S. Form 1120S, Schedule D, line 4

#### Line 32

Enter the amount of any gain on the sale exchange or involuntary conversion of property used in a trade or business and held for one year or less (from U.S. Form 4797).

#### Line 33

Enter the amount of any (loss) on the sale exchange or involuntary conversion of property used in a trade or business and held for one year or less (from U.S. Form 4797).

#### Line 34

Enter the net capital gain or (loss) from U.S. Form 1120S, Schedule D, line 10.

#### Line 35

Enter the net gain or (loss) under IRC section 1231 from U.S. Form 1120S, Schedule K, line 5.

#### Line 36

Enter in line 36 any long-term capital gain or (loss) that is not included in lines 34 and/or 35 that is granted capital gains treatment by the federal government or is classified as a capital gain or (loss) for Massachusetts purposes. For Massachusetts purposes capital gain or (loss) is the gain or (loss) from the sale or exchange of a capital asset. A capital asset is: (1) an asset which is capital asset for federal income tax purposes or (2) property that is used in a trade or business within the meaning of IRC section 1231(b) without regard to the holding period defined in said section 1231(b).

#### Line 37

Enter the amount of any gain from collectibles held for more than one year.

Collectibles are defined as any capital asset that is a collectible within the meaning of Internal Revenue Code section 408(m), as amended and in effect for the taxable year, including works of art, rugs, antiques, metals, gems, stamps, alcoholic beverages, certain coins, and any other items treated as collectibles for federal tax purposes.

#### Line 38

Report any adjustments to Massachusetts capital gain and (losses). Attach a complete statement explaining any such adjustments.

If an S corporation is taxable at the federal level, and thus the state level, on certain capital gains under IRC Section 1374, then the amount of the capital gains passed through to the shareholder is reduced by the tax paid at the federal and state level. Reduce the S corporation's capital gain by the amount of federal and state tax

paid by the S corporation and attach the computation of the tax shown on U.S. Form 1120S, line 22(b).

#### Part IV Resident and Nonresident Reconciliation

Part IV should be completed only if ALL three of the following conditions are met: (a) there is one or more nonresident shareholders; (b) there is any income derived from business activities or ownership of any interest in real or tangible property in another state; (c) such business activities provide the other state the jurisdiction to levy any income or franchise tax.

When completing line 40 exclude any income from unrelated business activities prior to apportionment, see 830 CMR 63.38.1, sections (3) and (4). Attach a statement and explain any adjustments.

Form 355S-A or 355S-B, Schedule F should be completed before filling out Part IV.

### Schedule SK-1. Shareholder's Massachusetts Information

#### Shareholder's Distributive Share

The shareholder's distributive share of each item of income, loss, deduction, or credit is determined by the shareholder's percentage of ownership of stock in the S corporation computed on a daily basis during the taxable year.

- For a nonresident shareholder eligible to apportion, enter in column (b), lines 1 through 21, the amount of the shareholder's share of each applicable distributive share item multiplied by the apportionment percentage in Form 355S-A or 355S-B, Schedule F, line 5.

**Note:** For line 8, enter in column (b) the amount of the nonresident shareholder's distributive share without apportionment.

- For all other shareholder's, enter in column (b), lines 1 through 21 the amount of the shareholder's share of each applicable distributive share item.
- For lines 17, 18, 19 and 20 the S corporation may provide each shareholder with a written breakdown of long-term capital gains and (losses) by the applicable holding periods of: more than one year but not more than two years; more than two years but not more than three years; more than three years but not more than four years; and more than four years.

#### Line 1

Enter the amount of the shareholder's share of the S corporation's Massachusetts ordinary income or (loss) from Schedule S, line 20. For a nonresident eligible to apportion, enter the amount of the shareholder's share of the S corporation's Massachusetts ordinary income or (loss) multiplied by the apportionment percentage in Schedule F, line 5.

#### Line 2

Report and describe in line 2 any other expense that is deductible from income taxed at 5.95% and properly reportable on Massachusetts Form 1 or 1-NR/PY, Schedule E, Part II, or Form 2 and is not reported elsewhere on Schedule SK-1. Examples of such deductions include oil and gas depletion and the expense deduction for recovery property, IRC Sec. 179. An estate or trust may not elect to expense recovery property.

#### Line 3

Combine the amounts in lines 1 and 2. The line 3 result includes each shareholder's share of the S corporation's Massachusetts ordinary income.

The correct Massachusetts amount of the shareholder's share of ordinary income may differ from the comparable U.S. total reported on the shareholder's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, line 17; or Form 3F. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2, and line 4 if applicable; Form 2, line 17; or Form 3F, to reflect the correct Massachusetts amount. Each shareholder should attach a statement with the shareholder's Massachusetts tax return and explain the adjustments.

The S corporation should also provide each shareholder with the amount of any costs of renovating a qualifying abandoned building. Each shareholder should use this amount to complete Form 1 or 1-NR/PY, Schedule E, Part II, line 4; Form 2; or Form 3F. Attach a statement detailing the location and cost of renovating the qualifying abandoned building.

The S corporation should provide each shareholder with the amount of the shareholder's share of any 5.95% interest from Massachusetts banks and interest (other than from Massachusetts banks) and dividend income included in line 3. Each shareholder should use these amounts to complete Form 1 or 1-NR/PY, Schedule E, Part II, lines 6 and 7; Form 2; or Form 3F.

#### Line 4

Enter the shareholder's share of any tax due from the S corporation to any other state, territory or possession of the United States, or Canada or any of its provinces on income taxable to the shareholder in Massachusetts and otherwise allowable as a credit to individuals.

This credit is available only to resident shareholders and may be taken by using Form 1, Schedule Z, or Form 1NR/PY, Schedule Z or if applicable, on Form 2. Where the credit is available, the S corporation must also provide each resident shareholder with separately stated totals of 5.95%, interest (other than from Massachusetts banks), dividends and certain capital gains taxed at 12% income and long-term capital gain taxed by other jurisdictions to enable each shareholder to calculate the amount of the credit. The S corporation should provide each shareholder with the names of each applicable jurisdiction and the amount taxed.

Enter the shareholder's share of any credit due to the S corporation for expenses incurred by the S corporation for covering or removing lead paint on residential premises in Massachusetts.

Enter the shareholder's share of any Economic Opportunity Area credit. The S corporation must provide each shareholder with a completed Schedule EOA, Economic Opportunity Area Credit.

Enter the shareholder's share of any Full Employment Credit. The S corporation must provide each shareholder with a completed Schedule FEC, Full Employment Credit.

#### Line 5

Enter the shareholder's share of the S corporation's net rental income or (loss) from real estate activities from Schedule S, line 21.

The correct Massachusetts amount of the shareholder's net income or (loss) from rental real estate activities may differ from the comparable U.S. total reported on the shareholder's Form 1, or 1-NR/PY, Schedule E, Part II, line 1; Form 2, Schedule E, line 1; or Form 3F. Each shareholder should make adjustments in Form 1, or 1-NR/PY, Schedule E, Part II, line 2; Form 2, Schedule E, line 2; or Form 3F to reflect the correct Massachusetts amount. Each shareholder should attach a statement with the shareholder's Massachusetts tax return and explain.

#### Line 6

Enter the shareholder's share of the S corporation's net rental income or (loss) from other activities from Schedule S, line 22.

The correct Massachusetts amount of the shareholder's share of net rental income or (loss) from other activities may differ from the comparable U.S. total reported on the shareholder's Form 1 or 1-NR/PY, Schedule E, Part II, line 1; Form 2, line 17; or Form 3F. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule E, Part II, line 2; Form 2, line 17; or Form 3F to reflect the correct Massachusetts amount. Each shareholder should attach a statement with the shareholder's Massachusetts tax return and explain.

#### Line 7

Enter the shareholder's share of the S corporation's 5.95% interest from Massachusetts banks from Schedule S, line 25. For a nonresident eligible to apportion, enter the shareholder's share of the S corporation's 5.95% interest from Massachusetts banks multiplied by the apportionment percentage in Schedule F, line 5.

Each shareholder should include the line 7 total in Form 1, line 5, or 1-NR/PY, line 7; Form 2, line 16; or Form 3F.

Each nonresident shareholder whose income is apportioned should receive from the S corporation the amount of the shareholder's pre-apportionment share of 5.95% interest from Massachusetts banks. Each nonresident individual whose income is apportioned should include this amount in Form 1-NR/PY, Schedule B, line 5. This amount should be used instead of any amount from Form 1-NR/PY, line 7 because the shareholder's full distributive share of such income is included in the U.S. amount reported in Schedule B-NR/PY, line 1. Each nonresident trust or estate whose income is apportioned should include its pre-apportionment share of 5.95% interest from Massachusetts banks in Form 2, Schedule B, line 6, instead of any amount from Form 2, line 16.

#### Line 8

Enter the shareholder's share of the S corporation's interest on U.S. debt obligations from Schedule S, line 24. For a nonresident shareholder eligible to apportion, enter the shareholder's share without apportionment. This income is taxable by the federal government, but tax-exempt in Massachusetts.

Each shareholder should include the line 7 total in Form 1 or 1-NR/PY, Schedule B, line 6; Form 2, Schedule B, line 5; or Form 3F, Schedule B, line 7.

#### Line 9

Enter the shareholder's share of the S corporation's non-Massachusetts state and municipal bond interest from Schedule S, line 27. For a nonresident shareholder eligible to apportion, enter the shareholder's distributive share of the S corporation's non-Massachusetts state and municipal bond interest multiplied by the apportionment percentage in Schedule F, line 5. This income is not taxed by the federal government, but is taxable in Massachusetts.

Each shareholder should include the line 9 total in Form 1, 1-NR/PY, 2 or 3F, Schedule B, line 3.

#### Line 10

Enter the shareholder's share of the S corporation's interest (other than from Massachusetts banks) and dividend income from Schedule S, line 26. For a nonresident shareholder eligible to apportion, enter the shareholder's distributive share of the (other than from Massachusetts banks) interest and dividend income from Schedule S, line 26, multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of (other than from Massachusetts banks) interest and dividend income may differ from the comparable U.S. total reported on the shareholder's Form 1, 1-NR/PY, 2, Schedule B, lines 1 and 2; or Form 3F. Each shareholder should make adjustments to reflect the correct Massachusetts amount in Form 1 and 1-NR/PY, Schedule B, line 6; Form 2, Schedule B, line 8; or Form 3F. Each shareholder should attach a statement to the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 11

Enter the shareholder's share of the S corporation's royalty income from Schedule S, line 28. For a nonresident shareholder eligible to apportion, enter the shareholder's distributive share of the S corporation royalty income from Schedule S, line 28, multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of royalty income may differ from the comparable U.S. total reported on the shareholder's Form 1, or 1-NR/PY, Schedule E, Part I, line 1; Form 2, Schedule E, line 1; or Form 3F. Each shareholder should make adjustments to reflect the correct Massachusetts amount in Form 1, or 1-NR/PY, Schedule E, Part I, line 2; Form 2, Schedule E, line 2; or Form 3F. Each shareholder should attach a statement to the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 12

Enter the shareholder's share of the S corporation's income from Schedule S, line 29. For a nonresident shareholder eligible to apportion, enter the shareholder's distributive share of the S corporation's other income from Schedule S, line 29 multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of other income may differ from the comparable U.S. total reported on the shareholder's Form 1, 1-NR/PY, 2 or 3F. Each partner should make adjustments on the applicable lines of Form 1, 1-NR/PY, 2 or 3F to reflect the correct Massachusetts amount. If any income reported to the S corporation from a Real Estate Mortgage Investment Conduit (REMIC) in which the S corporation is a residual interest holder is reported in line 12, then any such adjustment should be made on Form 1, or 1-NR/PY, Schedule E, Part I, line 2 or Form 2, Schedule E, line 2. Each shareholder should attach a statement to the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 13

Enter the shareholder's share of the S corporation's short-term capital gain from Schedule S, line 30. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the S corporation's short-term capital gain or (loss) multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of short-term capital gain may differ from the comparable U.S. total reported on the shareholder's Form 1, or 1-NR/PY, Schedule B, line 8; Form 2, Schedule B, line 11; or Form 3F. Each shareholder should make adjustments in Form 1, 1-NR/PY, Schedule B, line 8 or Form 2, Schedule B, line 11; or Form 3F to reflect the correct Massachusetts amount. Each shareholder should attach a statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 14

Enter the shareholder's share of the S corporation's short-term capital (losses) from Schedule S, line 31. For a nonresident shareholder

eligible to apportion, enter the shareholder's share of the S corporation's short-term capital (losses) multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of short-term capital (losses) may differ from the comparable U.S. total reported or the shareholder's Form 1, 1-NR/PY or 2, Schedule B, or Form 3F. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 14; Form 2, Schedule B, line 17; or Form 3F. Each shareholder should enclose a statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 15

Enter the shareholder's share of the S corporation's gain on the sale exchange or involuntary conversion of property used in trade or business and held for one year or less from Schedule S, line 32. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the S corporation's gain on the sale exchange or involuntary conversion of property used in trade or business and held for one year or less multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of gain on the sale, exchange or involuntary conversion of property used in trade or business and held for one year or less may differ from the comparable U.S. total reported or the shareholder's Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 10; Form 2, Schedule B, line 13; or Form 3F. Each shareholder should enclose a statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 16

Enter the shareholder's share of the S corporation's (loss) on the sale, exchange or involuntary conversion of property used in trade or business and held for one year or less from Schedule S, line 33. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the S corporation's (loss) on the sale exchange or involuntary conversion of property used in trade or business and held for one year or less multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of (loss) on the sale, exchange or involuntary conversion of property used in trade or business and held for one year or less may differ from the comparable U.S. total reported or the shareholder's Form 1, 1-NR/PY, 2 or 3F, Schedule B. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule B, line 15, Form 2, Schedule B, line 18; or Form 3F. Each shareholder should enclose a statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 17

Enter the shareholder's share of the S corporation's long-term capital gain or (loss) from Schedule S, line 34. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the long-term capital gain or (loss) multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of long-term capital gain or (loss) may differ from the comparable U.S. total reported on Form 1, 1-NR/PY, 2 or 3F, Schedule D, line 1. Each shareholder should make adjustments in Form 1, 1-NR/PY, Schedule D, line 8; Form 2, Schedule D, line 10; or 3F, to reflect the correct Massachusetts amount. Each shareholder should attach a

statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 18

Enter the shareholder's share of the S corporation's Section 1231 gain or (loss) from Schedule S, line 35. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the S corporation's Section 1231 gain or loss (loss) multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of Section 1231 gain or (loss) may differ from the comparable U.S. total reported or the shareholder's Form 1, 1-NR/PY, 2 or 3F, Schedule D. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule D, line 8; Form 2, Schedule D line 10; or Form 3F. Each shareholder should enclose a statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Line 19

Enter the shareholder's share of the S corporation's other long-term capital gains or (losses) from Schedule S, line 36. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the S corporation's other long-term capital gains and (losses) multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of other long-term capital gains or (losses) may differ from the comparable U.S. total reported on the shareholder's Form 1, 1-NR/PY, 2 or 3F, Schedule D, line 1. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule D, lines 6 and/or 8, Form 2, Schedule D, lines 6 and/or 10; or Form 3F.

#### Line 20

Enter the shareholder's share of the S corporation's long-term gains on collectibles from Schedule S, line 37. For a nonresident shareholder eligible to apportion, enter the shareholder's share of the S corporation's long-term gains on collectibles multiplied by the apportionment percentage in Schedule F, line 5.

The correct Massachusetts amount of the shareholder's share of long-term gains on collectibles may differ from the comparable U.S. total reported or the shareholder's Form 1, 1-NR/PY or 2, Schedule D, line 1. Each shareholder should make adjustments in Form 1 or 1-NR/PY, Schedule D, line 8 or Form 2, Schedule D, line 10. Each shareholder should enter the correct Massachusetts amount in Form 1 or 1-NR/PY, Schedule D, line 10 or Form 2, Schedule D, line 12. Each shareholder should enclose a statement with the shareholder's Massachusetts tax return and explain any adjustments.

#### Shareholder's Basis Information

The information in lines 22 through 26 may be needed by the shareholder to determine the limitation of losses passed through to the shareholder, or the gain or (loss) from sale or other disposition of the shareholder's stock and indebtedness.

#### Line 22

For a calendar year S corporation, enter in line 22 the number of the shareholder's shares and the amount of the shareholder's federal basis as of 12/31/85. If the S corporation was a fiscal year entity, enter the number of the shareholder's shares and the amount of the shareholder's federal basis as of the last day of the taxable year prior to becoming a Massachusetts S corporation.

If the S corporation became a Massachusetts S corporation after 12/31/86, enter in line 22 the number of the shareholder's shares and the amount of the shareholder's federal basis as of the last day

of the taxable year prior to becoming a Massachusetts S corporation. If reporting a federal basis other than 12/31/85, specify the year.

#### Line 24

Enter the net amount of the adjustments made to the shareholder's Massachusetts basis for the taxable year. The shareholder's basis should be increased by the shareholder's distributive share of S corporation income, decreased by distributions to the shareholder, and otherwise adjusted to reflect changes that affect the basis of the stock. Make comparable entries for adjustments to the shareholder's Massachusetts indebtedness. More detailed information on Massachusetts basis adjustment is provided in 830 CMR 62.17A.1.

#### Line 25

Enter the net amount of the adjustments made to the shareholder's federal basis for the taxable year. Make comparable entries for adjustments to the shareholder's federal indebtedness.

### Computation of Excise

The Computation of Excise schedule on the front of Form 355S-A and 355S-B is used to calculate the various measures of the Massachusetts S corporation excise. These are:

- a tax of \$2.60 per \$1,000 on whichever applies of taxable Massachusetts tangible property or taxable net worth; and
- a tax of 3% on net income if the S corporation's total receipts are \$6 million or more, but less than \$9 million; or
- a tax of 4.5% on net income if total receipts are \$9 million or more;
- a tax of 9.5% on income taxed at the federal level.

The law also provides for a minimum excise of \$456.

#### Line 3

S corporations in Massachusetts are taxed at 9.5% on certain capital gains taxable at the federal level under IRC Section 1374 and on passive investment income taxable at the federal level under IRC Section 1375. Such income earned by an S corporation must be entered in line 3 of the Computation of Excise section but subtracted from any income amount to be entered in line 4b.

#### Line 16

The sum of the credits listed in lines 7 through 11 allowable in any one taxable year is limited to 50% of the corporate excise. Unapplied credits may be carried forward. There is no carryback. Complete Schedule H to calculate the amount of each credit that may be used currently and the amounts that may be carried forward.

#### Line 18

The minimum excise for a domestic or foreign S corporation is \$456. A corporation owes at least the minimum tax and this excise can never be prorated as Massachusetts law makes no provision for the proration of the minimum tax.

#### Line 20

Any corporation that wishes to contribute any amount to the Natural Heritage and Endangered Species Fund may do so on this form. This amount is added to the excise due. It increases the amount of the corporation's payment or reduces the amount of its refund.

The Natural Heritage and Endangered Species Fund is administered by the Massachusetts Department of Fisheries, Wildlife and Environmental Law Enforcement to provide for conservation programs for rare, endangered and nongame wildlife and plants in the Commonwealth.

#### Line 23

Enter the amount of any 1998 overpayment applied to your 1999 estimated taxes.

#### Line 24

Enter the total estimated payments for 1999. Do not include any amount from line 23 in this amount.

#### Line 25

Enter any amount paid with an extension on this line. Attach a copy of the extension (Form 355-7004) to the return.

### Refunds

If the amount in lines 23, 24 and 25 exceeds the amount in line 22, the company may have the overpayment credited to the next tax year or may have a portion of the overpayment credited to the following year and a portion refunded.

#### Line 26

Enter the amount of the overpayment.

#### Line 27

Enter the amount of the overpayment to be credited to your 2000 estimated tax.

#### Line 28

Enter the amount of the overpayment to be refunded.

#### Line 30

The following penalties apply:

**Penalty for Underpayment of Estimated Tax.** An additional charge for the period of any underpayment may be imposed on corporations which underpay their estimated taxes or fail to pay estimated taxes. Form M-2220, Underpayment of Massachusetts Estimated Tax by Corporations, should be used to compute any underpayment penalty.

**Penalty for Failure to File.** The penalty for failure to file a tax return by the due date is 1% of the tax due per month (or fraction thereof), up to a maximum of 25%.

**Penalty for Late Payment.** The penalty for failure to pay the total payment due with this form is ½% of the tax due per month (or fraction thereof), up to a maximum of 25%. A late payment penalty does not apply to amended returns when the amount shown on the original return was paid.

Any corporation which fails to pay its tax when due will be subject to interest charges.

#### Line 32

Enter the total payment due. Checks for this amount should be made payable to the **Commonwealth of Massachusetts**. Checks should have the corporation's Federal Identification Number written in the lower left corner.

### Signature

When the form is complete, it must be signed by the treasurer or assistant treasurer or, in their absence or incapacity, by any other principal corporate officer. The social security number of the signing officer should be entered next to the date the return was signed. If you are filing as an authorized delegate of the appropriate corporate officer, check the box in the signature section and attach a copy of Massachusetts Form M-2848, Power of Attorney. The form must

also be signed by any paid preparer of the form. The form should be mailed to:

**Massachusetts Department of Revenue**  
**PO Box 7025**  
**Boston, MA 02204**

**Note:** Corporations requesting alternative apportionment should mail their return to PO Box 7044.

**Practitioner Identification Number.** For tax returns filed in the year 2000 the Department will permit practitioners to use in lieu of their Social Security number their IRS issued Preparer Taxpayer Identification Number (TPIN).

## Where to Get Forms and Publications

To obtain Massachusetts forms and publications by phone, call the Department's main information lines at (617) 887-MDOR, or toll-free in Massachusetts at 1-800-392-6089. Please note that many forms and publications are available 24 hours a day by calling the Department's automated forms request system at the numbers listed above.

Beginning this year, DOR is pleased to offer taxpayers and tax practitioners the convenience of obtaining many Massachusetts tax forms and publications via the Internet. The address for the Department's web site is [www.state.ma.us/dor](http://www.state.ma.us/dor).

Certain forms and publications can be obtained through DOR's Fax on Demand system. For a complete Fax on Demand menu, please dial (617) 887-1900 using the handset and the keypad on your fax machine.

## For General Tax Information

Please call (617) 887-MDOR or toll-free in Mass. at 1-800-392-6089.

**For help in one of the following specific areas, please call the number listed below:**

- Certificates of Good Standing (617) 887-6550
- Installment sales (617) 887-6950
- Federal changes (617) 887-6800
- Small Business Workshop (617) 887-6400
- Teletype (TTY): (617) 887-6140
- Vision-impaired taxpayers are welcome to make an appointment at any DOR office listed on this page to receive assistance in preparing their tax forms.

To report allegations of suspected misconduct or impropriety involving Department of Revenue employees, please call the Inspectional Services Division's Integrity Hot Line at 1-800-568-0085 or write to PO Box 6040, Boston, MA 02114.

### DOR Locations in Massachusetts

19 Staniford Street  
**Boston** 02204

(617) 887-MDOR

218 S. Main Street

**Fall River** 02721

(508) 678-2844

1019 Iyanough Road

**Hyannis** 02601

(508) 771-2414

333 East Street

**Pittsfield** 01201

(413) 499-2206

436 Dwight Street

**Springfield** 01103

(413) 784-1000

40 Southbridge Street

**Worcester** 01608

(508) 792-7300

### DOR Locations throughout the Country

1355 Peachtree Street, NE  
Suite 1280

**Atlanta**, GA 30309

(404) 874-2922

101 South First Street

4th Floor

**Burbank**, CA 91502

(818) 840-9059

150 N. Michigan Avenue

Suite 2035

**Chicago**, IL 60601

(312) 899-9040

2603 Augusta Drive

Suite 1075

**Houston**, TX 77002

(713) 784-7225

1440 Broadway, 22nd floor

**New York**, NY 10022

(212) 768-2750

355 Fifth Avenue

Suite 1400

**Pittsburgh**, PA 15222

(412) 281-2776





# Technical Information Release

Commonwealth of Massachusetts

Department of Revenue

## TIR 97-6

### Effect of Recent Federal Tax Law Changes on the Taxation of S Corporations and Their Shareholders

#### I. Introduction.

The federal Small Business Job Protection Act of 1996 (the "Act") has eliminated or eased several restrictions on federal S corporation eligibility. In addition, the Act amended the federal law to allow federal S corporations to own "qualified S corporation subsidiaries." This Technical Information Release (TIR) explains how these federal tax law changes affect federal S corporations' eligibility for S corporation treatment under the Massachusetts personal income tax and corporate excise.

In general, the Massachusetts personal income tax relies on the definitions found in the 1988 Internal Revenue Code. G.L. c. 62, § 1. However, for the limited purpose of defining S corporations and characterizing income as S corporation income, the Massachusetts S corporation regulation adopts the current Code with certain additional eligibility requirements. See 830 CMR 62.17A.1(2). For corporate excise purposes, Massachusetts generally adopts the current Code. See e.g., G.L. c. 63, §§ 30.3, 30.4, 32D. Thus, as discussed in Section II.C., below, a corporation that meets the expanded definition of an S corporation for federal tax purposes will be eligible for S corporation treatment in Massachusetts if it is otherwise eligible for such treatment under the S corporation regulation. In addition, where a corporation is eligible for Massachusetts S corporation treatment and has a qualified S corporation subsidiary, the subsidiary's items of income, loss and deduction pass through to the parent's shareholders as explained in Section III.C., below. Finally, both federal S corporations and qualified S corporation subsidiaries are subject to the corporate excise as discussed in Sections II.D., and III.D., below.

#### II. Expanded S Corporation Eligibility.

##### A. Federal Tax Law Change.

Starting with 1997 taxable years, the Act makes it easier for corporations to qualify as federal S corporations and to remain eligible for federal S corporation treatment. Specifically, S corporations may now have 75 shareholders whereas only 35 shareholders were permitted under prior law. See IRC § 1361(b)(1)(A), as amended by P.L. 104-88 § 1301. In addition, certain entities that were previously ineligible to be S corporation shareholders may now own S corporation shares. See e.g., IRC § 1361(c)(2), as amended by P.L. 104-88 §§ 1302, 1303 (expanding the eligibility of trusts to own S corporation shares); IRC § 1361(c)(7), as amended by P.L. 104-88 § 1316(a)(2) (permitting certain tax exempt organizations to own S corporation shares).

##### B. Current Massachusetts Law; Definitions of S Corporation.

For personal income tax purposes, an S corporation is defined as "an entity described at Code [section] 1361, *as amended and in effect for the taxable year.*" 830 CMR 62.17A.1(2). For corporate excise purposes, an S corporation is any domestic or foreign business corporation, manufacturing corporation or research and development corporation that is an S corporation under the Internal Revenue Code *as amended and in effect for the taxable year.* G.L. c. 63, § 32D. Thus, Massachusetts relies on the *current* Internal Revenue Code for purposes of defining S corporations under both the personal income tax and the corporate excise.

##### C. Personal Income Tax; Treatment of S Corporation Shareholders.

A corporation (excluding a corporate trust) that is an S corporation under the new federal eligibility rules is eligible to be treated as an S corporation under the Massachusetts personal income tax notwithstanding the differences between the current Code and the 1988 Code. Thus, a federal S corporation (excluding a corporate trust) must pass its items of income, loss and deduction through (i) to its resident shareholders if it is required to do so under 830 CMR 62.17A.1(5) and (ii) to its non-resident and part-year resident shareholders if it is required to do so under 830 CMR 62.17A.1(6) and (7). The taxability of a federal S corporation's actual distributions to shareholders is determined under 830 CMR 62.17A.1(10).

#### D. Corporate Excise; Taxation of Corporate Entity.

All domestic business, manufacturing, and research and development corporations are subject to the excise imposed by G.L. c. 63, § 32. All foreign business, manufacturing, and research and development corporations doing business in Massachusetts are subject to the excise imposed by G.L. c. 63, § 39. In the case of any foreign or domestic business, manufacturing or research and development corporation that is also a federal S corporation, the income measure of the excise is determined under G.L. c. 63, § 32D. Any corporation (excluding a corporate trust) that qualifies as a federal S corporation under the new federal eligibility rules will be subject to the corporate excise under Section 32 or 39 and Section 32D. See 830 CMR 62.17A.1(3).

### III. Qualified S Corporation Subsidiaries.

#### A. Federal Tax Law Change.

The Act allows S corporations to own qualified S corporation subsidiaries starting with 1997 taxable years. See IRC § 1361(b)(3), added by P.L. 104-88 § 1308(b). Such subsidiaries must be wholly owned by the S corporation parent. IRC § 1361(b)(3)(B)(i). The parent must elect qualified S corporation treatment for its subsidiary. IRC § 1361(b)(3)(B)(ii). For federal tax purposes, the qualified S corporation subsidiary is not treated as a separate corporation. Rather all of the subsidiary's assets, liabilities, and items of income, deduction and credit are treated as those of the S corporation parent. IRC § 1361(b)(3)(A). These items are then flowed through to the shareholders as provided in IRC § 1366.

#### B. Current Massachusetts Law; S Corporation Subsidiaries.

Massachusetts law makes no specific provision for qualified S corporation subsidiaries. Thus, in the case of a federal S corporation with a qualified S corporation subsidiary, the general principles of the S corporation regulation and the corporate excise statute apply as discussed below.

#### C. Personal Income Tax; Pass-through to Shareholders.

If an item of income, loss or deduction is treated as having flowed through a federal S corporation (excluding a corporate trust) for federal tax purposes, the item also passes through for Massachusetts personal income tax purposes if such pass-through is required under 830 CMR 62.17A.1(5)–(7). Where a shareholder receives an actual distribution from a federal S corporation (excluding a corporate trust), it is treated as an S corporation distribution under 830 CMR 62.17A.1(10). No provision of Massachusetts law changes these results where the S corporation owns a qualified S corporation subsidiary.

Thus, notwithstanding the differences between the current Code and the 1988 Code, where a federal S corporation (excluding a corporate trust) owns a qualified S corporation subsidiary, the subsidiary's items of income, loss, deduction and any other items necessary to determine the shareholders' personal income tax liability pass-through to the shareholders of the S corporation to the extent such pass-through is required under 830 CMR 62.17A.1(5)–(7). For personal income tax purposes, such items are treated as though they were realized directly by the parent. Where a federal S corporation (excluding a corporate trust) makes an actual distribution of income earned in whole or in part by a qualified S corporation subsidiary, the taxability of the distribution is determined under 830 CMR 62.17A.1(10), as though the entire amount distributed was earned directly by the parent. A corporation that is treated as an S corporation for Massachusetts purposes and that owns a qualified S corporation subsidiary must take all of the subsidiary's attributes into account when determining its apportionment factors and when maintaining its accounts for accumulated adjustments, basis and earnings and profits under the S corporation regulation.

#### D. Corporate Excise; Taxation of Corporate Entity.

All domestic business, manufacturing or research and development corporations are subject to the corporate excise imposed by G.L. c. 63, § 32. All foreign business, manufacturing or research and development corporations doing business in Massachusetts are subject to the corporate excise imposed by G.L. c. 63, § 39. In the case of a corporation that is a federal S corporation, the net income measure of the excise is determined under G.L. c. 63, § 32D. No provision of the corporate excise allows the Commissioner to disregard the existence of a qualified S corporation subsidiary that falls within the definition of a domestic or foreign corporation under G.L. c. 63, § 30. Therefore, qualified S corporation subsidiaries and their S corporation parents (excluding corporate trusts) are both subject to the corporate excise as provided below.

**1. Qualified S Corporation Subsidiaries:** A qualified S corporation subsidiary doing business in Massachusetts must file a corporate excise return to report (i) any corporate excise attributable to its taxable tangible property or taxable net worth and (ii) the minimum corporate excise. A qualified S corporation subsidiary is not, itself, subject to the net income measure of the corporate excise since all of its income is treated as that of the parent under the Code.

**2. S Corporation Parents:** An S corporation parent must take into account the activities of its qualified S corporation subsidiaries in determining whether the parent is doing business in Massachusetts. For purposes of this determination, all of the subsidiary's activities will be attributed to the parent. For purposes of determining whether, and at what rate, an S corporation parent is subject to the net income measure of the corporate excise under Section 32D, the parent must aggregate its total receipts with those of its qualified S corporation subsidiaries as provided in 830 CMR 62.17A.1(11). Finally, if the net income measure does apply, the S corporation parent must take the subsidiary's items of income, loss and deduction into account in determining the parent's net income and must include the subsidiary's property, payroll, and sales in determining the parent's apportionment factors.

For purposes of determining the corporate excise attributable to the parent's taxable tangible property or taxable net worth, separate accounting is required. The assets, liabilities, income, deductions and credits of the parent and the qualified S corporation subsidiary are not combined and intercompany transactions are not eliminated for this purpose. Rather, the parent and the subsidiary each determine and report their taxable tangible property or taxable net worth based on their own separate attributes.



Mitchell Adams  
Commissioner of Revenue

May 8, 1997

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Department of  
Revenue  
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Boston, MA 02204

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## Dear Taxpayer,

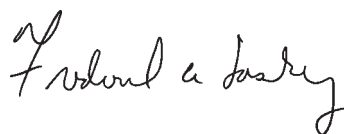
At the Massachusetts Department of Revenue (DOR), digital technology is making it easier than ever to file your state tax return. Last year, 446,000 taxpayers used DOR's Telefile and PC File programs to file their taxes. Those entitled to refunds received them within four days! This year, we have simplified both programs and expanded eligibility so that even more taxpayers will be able to use them.

For more information on these programs or to download DOR's free PC File software, please visit our website, [www.state.ma.us/dor](http://www.state.ma.us/dor). Both Telefile and PC File allow you to deposit your refund check directly into your bank account. Telefile allows you to use your credit or bank card to pay any tax due.

Improving the quality of our service to you is my highest priority. I have created a new position within DOR — the Taxpayer Advocate — whose job is to see that taxpayers' complaints are identified and resolved as quickly as possible. Thanks to the Legislature, DOR now has the authority to settle tax disputes much sooner than in the past. The new state budget includes provisions that repeal the requirement that disputed taxes must be paid before they can be appealed.

In the coming year, I look forward to working with taxpayers and tax specialists across the Commonwealth to improve even further the service that DOR provides.

Sincerely,



Frederick A. Laskey  
Commissioner of Revenue